The Commonwealth of Massachusetts

DEPARTMENT OF
TELECOMMUNICATIONS AND ENERGY

D.T.E. 06-9 March 29, 2006

Petition of Boston Gas Company, Colonial Gas Company, and Essex Gas Company, each d/b/a KeySpan Energy Delivery New England, for approval pursuant to G.L. c. 164, § 94A, of a natural gas asset optimization service contract with KeySpan Corporate Services, LLC, and Merrill Lynch Commodities, Inc.

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I. INTRODUCTION

On January 31, 2006, Boston Gas Company, Colonial Gas Company, and Essex Gas Company, each d/b/a/ KeySpan Energy Delivery New England (collectively, "KeySpan" or "Company"), pursuant to G.L. c. 164, § 94A, submitted for approval by the Department of Telecommunications and Energy ("Department") a natural gas asset optimization service contract ("Agreement") executed by KeySpan Corporate Services, LLC as agent for KeySpan (also referred to as "KeySpan" or "Company") and Merrill Lynch Commodities, Inc. ("MLCI"). The Department has previously approved similar asset management agreements in KeySpan Energy Delivery New England, D.T.E. 04-9 (2004) ("EKT Agreement"),[1] and Boston Gas Company, Colonial Gas Company and Essex Gas Company, D.T.E. 99-76 (1999). The Company's proposal was docketed as D.T.E. 06-9.

On February 27, 2006, pursuant to notice duly issued, the Department conducted a public hearing to afford interested persons the opportunity to comment on KeySpan's proposal. The Attorney General of the Commonwealth ("Attorney General") intervened as of right pursuant to G.L. c. 12, § 11E, and the Department granted Bay State Gas Company's motion for limited participant status.

On March 13, 2006, the Department conducted an evidentiary hearing. The Company presented the testimony of Elizabeth D. Arangio, director of gas supply planning. The Company and the Attorney General filed initial briefs on March 16, 2006, and reply briefs on

[1] Entergy-Koch Trading, LP, was acquired by MLCI shortly prior to the Department's approval of the existing asset management arrangement in D.T.E. 04-9 (Exh. EDA-1, at 5).

March 21, 2006. The evidentiary record consists of 36 exhibits and two responses to record requests.

II. DESCRIPTION OF THE FILING

A. Request for Proposals Process

KeySpan's current asset management agreement, the EKT Agreement, expires on March 31, 2006 (Exh. EDA-1, at 13). Hence, on June 17, 2005, KeySpan commenced a request for proposal ("RFP") process to secure the services of a portfolio manager commencing April 1, 2006 (id.). The RFP was sent to 23 parties with initial bids due on July 29, 2005 (id.). KeySpan received four bids, with only two of those for the three-year term sought by the Company (id.). The Company states that each bid was evaluated based on: (1) price; (2) experience; (3) flexibility; (4) contract exceptions; and (5) creditworthiness (Exh. KED-AG-1-2, Att. 1). The Company further states that, in order to ensure a fair, open, and transparent process, the Company asked all bidders to submit written questions regarding the RFP; KeySpan then distributed written responses to the combined set of questions to all of the bidders that had executed a confidentiality agreement with the Company (Exhs. KED-AG-1-3; KED-DTE-1-2).

KeySpan indicated that after a period of internal review, the Company commenced negotiations with all four bidders (Exh. EDA-1, at 13). Following the hurricane devastation in the Gulf, KeySpan asked that the four bidders refresh their bids to: (1) clarify the resources that would be available to the asset manager; and (2) identify whether the occurrence of the two hurricanes in the Gulf had any impact on the initial bids (Exhs. EDA-1, at 13;

KED-AG-1-6). The updated bids were received by KeySpan on September 13, 2005 (Exh. EDA-1, at 13).

The Company narrowed the field to two bidders, MLCI and the next highest scoring bidder, ConocoPhillips, and renewed negotiations with those two entities (Exhs. EDA-1, at 13; KED-DTE-1-6). During these negotiations, KeySpan determined that the declining number of asset managers exhibiting a willingness and ability to manage KeySpan's Massachusetts portfolio, in combination with market circumstances, indicated a need to solidify its in-house capability to perform the critical operations involved in the asset management function (Exh. EDA-1, at 15-17; Tr. at 28-29). After discussing the possibility of structuring the agreement as a co-management arrangement, one of the two bidders withdrew from negotiations (Exh. KED-DTE-1-2; Tr. at 62-63). KeySpan then selected MLCI as the winning bidder (Exh. KED-DTE-1-6).

B. MLCI Agreement

The Agreement is designed to achieve the following objectives: (1) to secure the gas supplies necessary to meet the firm requirements of KeySpan's sales customers over a three-year period commencing April 1, 2006; (2) to establish a structure that will ensure the requisite level of portfolio reliability over the long term; and (3) to maximize the value of assets contained in the gas-resource portfolio for the benefit of KeySpan customers (Exh. EDA-1, at 4).

From the perspective of customers, KeySpan indicated that the proposed Agreement with MLCI would operate in the exact same manner as the existing outsourcing arrangement, except that KeySpan would take an active role in day-to-day procurement and delivery activities, as well as the strategic transactions undertaken to derive value for customers (id. at 9-10). To implement the outsourcing arrangement, KeySpan stated that all or a portion of the Company's upstream transportation capacity and underground-storage assets will be released to MLCI (id. at 10). MLCI will have the obligation to deliver the maximum daily quantity associated with the assets released to it to meet the gas-supply requirements of KeySpan's firm sales customers (id. at 10-11). KeySpan will continue to manage the assets that are not released to MLCI (id. at 11). KeySpan will work with MLCI to handle day-to-day operational requirements, including the procurement of gas supplies, the scheduling and nominating of supplies, and all transactions undertaken to derive value from the portfolio assets (id.). KeySpan indicated that it will have frequent contact with MLCI to map out strategies for utilizing and optimizing the portfolio assets (id.).

C. Margin Sharing

Under the Agreement, MLCI and KeySpan would jointly guarantee a fixed minimum payment to customers (Exh. EDA-3, at Article VI (confidential); Tr. at 13-14). In addition to the minimum payment, customers would receive an allocation of any revenues generated in excess of the minimum payment (Exhs. EDA-1, at 10, 24; KED-DTE-1-3; KED-AG-1-7; KED-RR-DTE-1; Tr. at 13-14, 19-20). However, KeySpan would not share in the customer portion of the excess revenues as it currently does under the EKT Agreement (id.). Instead, KeySpan would share the excess revenues that are retained by MLCI (id.). Because the customer portion is not shared with KeySpan, the Company states that customers would receive a higher allocation of revenues than under the existing agreement (Exh. EDA-1, at 12-13; KED-RR-DTE-1 (confidential)). As compared to the EKT Agreement, MLCI would receive a smaller portion of the revenues exceeding the fixed payment and KeySpan would receive a larger share of revenues exceeding the fixed payment, in consideration of the higher level of risk and cost that would be incurred by KeySpan under the arrangement (KED-RR-DTE-1 (confidential)).

The Company anticipates $500,000 to $2.0 million in incremental costs for staffing, training, and systems development and maintenance in order to develop the capability to backstop the Massachusetts resource portfolio (Exhs. KED-DTE-1-4; KED-DTE-1-8; KED-AG-14). The Company has indicated that these costs will not be borne by the Company's customers, as such costs, incurred by the Company, will be mitigated through the revenue-sharing arrangement with MLCI (Exh. KED-DTE-1-4; Tr. at 74-75).

III. POSITIONS OF THE PARTIES

A. Request for Proposals Process

1. Attorney General

The Attorney General urges the Department to reject the Agreement because the Company's competitive selection process failed to provide a "fair, open and transparent" process (Attorney General Brief at 2). The Attorney General contends that the Company made a material change in the services it sought during the competitive selection process, but failed to provide all potential bidders with an RFP that accurately reflected the services being sought (id.; Attorney General Reply Brief at 1). Specifically, the Attorney General states that the original RFP sought an asset manager for a complete outsourcing arrangement (Attorney General Brief at 2, citing Tr. at 26; Exh. KED-AG-1-1(a)(b)). The Attorney General notes that after the Company selected two bidders, KeySpan decided it wanted to enter into a "co-management agreement" rather than a complete outsourcing but failed to inform all potential bidders of the change (id. at 3). The Attorney General argues that this resulted in an unfair and opaque process (id.). The Attorney General urges the Department to reject the Agreement and order the Company to initiate an RFP process that gives all potential bidders an opportunity to bid on a co-management arrangement (id.; Attorney General Reply Brief at 2).

2. KeySpan

KeySpan argues that the Agreement is the product of a competitive solicitation process that was fair, open, and transparent (KeySpan Brief at 7; KeySpan Reply Brief at 2). The Company states that the RFP was issued to a comprehensive list of wholesale marketers and that all substantive communications were in writing and distributed to all parties on an equal basis (KeySpan Brief at 7, citing Exhs. EDA-1, at 13; KED-DTE-1-2; KED-AG-1-1, at 12; KED-AG-1-3) The Company states it accepted two rounds of bids from all the competitors that submitted bids as a result of the initial RFP (id.).

The Company asserts that it evaluated the bids based on a five-factor point system (id., citing Exhs. KED-DTE-1-2; KED-AG-1-2). The Company states that it selected two entities for a "short-list" for a traditional outsourcing arrangement (id., citing Exhs. EDA-1, at 13; KED-DTE-1-2; KED-AG-1-2(supp.); KED-AG-1-3). The Company states that after it notified the two entities that they were on a short-list, the Company further informed them of its intention to change the structure of the arrangement (id., citing Tr. at 57-59). KeySpan states that it did not notify the two bidders that did not make the short list of the change in structure because those entities submitted bids that (1) were priced well below those of the short-list bidders; (2) contained other detracting features; and (3) would have remained in that relative position even under a co-management arrangement (id. at 7-8, citing Exh. KED-AG-1-2; Tr. at 24, 57-59; KeySpan Reply Brief at 3). The Company contends that it selected MLCI for three reasons: (1) MLCI offered the best value for customers under a co-management arrangement; (2) KeySpan's experience with MLCI under the current EKT Agreement suggests that it is a reliable and creditworthy partner; and (3) MLCI expressed a willingness to enter into a co-management arrangement (id., citing Exhs. EDA-1, at 14-15; KED-AG-1-2(supp.); KED-DTE-1-7).

According to KeySpan, the evidence demonstrates that (1) the evaluation process was outlined for bidders both in the RFP and in later communications between the Company and bidders; (2) the Company provided bidders with evaluation criteria and applied the criteria throughout the bid-assessment process; and (3) the Company engaged in a process to provide written questions and answers to bidders, which allowed bidders to receive clarification and better understand the Company's objectives on a fair and objective basis (id. at 7-8). The Company states that no bidders raised an objection to the RFP process and the bids were evaluated and the winning bidders selected based on the criteria set forth in the RFP (id.). Consequently, the Company asserts that the RFP process was fair, open, and transparent and should be approved by the Department (id.).

B. MLCI Agreement

1. Attorney General

The Attorney General contends that the Agreement fails to compare favorably to the range of alternative options reasonably available to the Company and its customers (Attorney General Brief at 3). The Attorney General also suggests that the Department should expand its standard of review of non-cost factors given the complexity of trades associated with asset optimization agreements (id. at 2). The Attorney General contends that the Company chose MLCI's proposal over a number of proposals that would have offered a higher guaranteed payment to customers (id. at 3, citing Exhs. KED-AG-1-6 (confidential); KED-AG-1-2(supp.) (confidential). According to the Attorney General, a review of past earnings shows that the December 2005 MLCI proposal that gave rise to the Agreement under review may not produce the level of savings for customers that they would have enjoyed under the proposals that the Company rejected (id. at 3-4, citing Exh. KED-DTE-1-6 (confidential)).

2. KeySpan

The Company contends that the Agreement meets the Department's standard for approval of a gas commodity contract (KeySpan Brief at 8). Specifically, KeySpan notes that the Department previously found that the EKT Agreement was consistent with KeySpan's most recently approved forecast and supply plan filing, KeySpan Energy Delivery, D.T.E. 01-105 (2003), because the contract replaced an existing supply source and did not constitute an "incremental" supply source not covered by the plan (id. at 9, citing D.T.E. 04-9, at 11). KeySpan emphasizes that this Agreement is replacing the existing EKT Agreement and is likewise an existing supply source and doe not constitute an "incremental" supply source (KeySpan Brief at 9). KeySpan notes that the contracts subject to the arrangement are the same contracts reviewed and approved by the Department in D.T.E. 01-105 and KeySpan Energy Delivery, D.T.E. 03-66 (2003), as well as those being reviewed in the Company's pending resource and requirements plan in KeySpan Energy Delivery, D.T.E. 05-68. KeySpan contends that the Agreement is designed to meet the portfolio objectives of flexibility, reliability, and diversity of supplies (KeySpan Brief at 9; Exh. EDA-1, at 12).

KeySpan also asserts that the Agreement compares favorably to current market offerings considering price and non-price factors (KeySpan Brief at 13). KeySpan notes that the Agreement would operate in the same manner as the existing EKT Agreement, which the Department found, in D.T.E. 04-9, would produce an overall net benefit (KeySpan Brief at 12-13; Exh. EDA-1, at 12). KeySpan emphasizes that customers will not pay more for their gas supplies than they would have absent the Agreement (KeySpan Brief at 13; Exh. EDA-1, at 12). Finally, KeySpan argues that customers will continue to receive the benefit of a guaranteed fixed payment, as well as receiving a share of the excess revenues achieved over and above the guaranteed payment without the need to share those revenues with KeySpan as they do under the existing EKT Agreement (KeySpan Brief at 13; Exh. EDA-1, at 12-13). Because of these factors, KeySpan asserts that the Agreement represents the highest possible value for customers in light of current market conditions and the need to meet critical portfolio objectives of reliability, flexibility, and diversity of supply (KeySpan Brief at 13; Exh. EDA-1, at 2-13).

C. Margin Sharing

1. Attorney General

The Attorney General argues that the Department should reject the Company's proposal because it is an attempt by KeySpan to circumvent the Department's margin sharing rules set out in Interruptible Transportation Investigation, D.P.U. 93-141-A (1996) (Attorney General Brief at 4). The Attorney General argues that the proposed Agreement creates an incentive for the Company to enter into transactions and to procure resources that would maximize margins at the expense of Massachusetts customers (id.). The Attorney General contends that KeySpan would have an incentive to procure high-cost assets that would generate higher margins for shareholders (id.). According to the Attorney General, customers would pay the cost for excess or high-cost assets through the Cost of Gas Adjustment Clause and the harm from such added cost may not be off-set by the customer share of the excess margin (id.).

2. KeySpan

KeySpan argues that under the co-management arrangement with MLCI, it will share the risk associated with the payment of a minimum amount to customers, which is not a feature of the existing arrangement (KeySpan Brief at 13, citing Exh. EDA-3, at Article VI; Tr. at 13-14). The Company notes that additional costs are expected for staffing, training and systems development in order to develop KeySpan's capability to backstop the Massachusetts resource portfolio (id., citing Exhs. KED-DTE-1-4; KED-DTE-1-8; KED-AG-14). KeySpan asserts that customers would not bear these additional costs because any incremental costs incurred by the Company would be mitigated through the revenue-sharing arrangement with

MLCI (id., citing Exh. KED-DTE-1-4; Tr. at 74-75). The Company argues that application of the Department's traditional margin sharing policy under D.P.U. 93-141-A would serve as a disincentive to the Company's investment in the management of the resource portfolio (id. at 14).

While KeySpan asserts that it is not seeking to change the margin sharing policy set forth in D.P.U. 93-141-A, the Company acknowledges that it is asking for approval of the Agreement with an allocation that falls outside the framework of that policy (id.). Under the proposed arrangement, KeySpan would share in the revenues that MLCI would have otherwise retained (id.). Because of the higher level of risk and cost that would be incurred by KeySpan under the co-management arrangement, KeySpan would receive a larger share and MLCI would receive a smaller share (id., citing KED-RR-DTE-1). In addition, KeySpan asserts that customers would receive a higher allocation of revenues than under the existing agreement because the customer portion is not shared with KeySpan (id., citing KED-RR-DTE-1).

KeySpan argues that treatment outside of D.P.U. 93-141-A is necessary and warranted for three main reasons: (1) it will enable the Company to enter into an arrangement with MLCI and thus gain expertise by working with them and co-managing the portfolio; (2) as a co-manager, KeySpan will be taking on additional risk in guaranteeing a portion of the fixed, minimum payment and entering into transactions designed to achieve value for the portfolio resources; and (3) KeySpan will incur incremental costs to meet the reliability needs of the overall resource portfolio (id. at 14-15, citing Tr. at 54-56). According to KeySpan, the co-management arrangement provides the incentive for a cooperative relationship that balances reliability with revenue optimization, which is beneficial for all (id. at 15).

D. Other Issues

1. Attorney General

The Attorney General also contends that the Agreement lacks external checks and audits, which leaves the Department without a means to monitor whether KeySpan and MLCI enter into transactions for the sole benefit of customers (Attorney General Brief at 4). The Attorney General also argues the Agreement fails to mandate audits and fails to state risk assessment requirements that could offer some level of customer protection (id., citing Exh. EDA-3, Article XII, Section 12.2, at 20; Tr. at 48-53). The Attorney General notes that the Company stated it will not audit transactions unless it determines an audit is needed (id., citing Tr. at 49-53).

The Attorney General notes that, while KeySpan states it could provide gas to customers on a daily basis without an asset manager on a short-term basis, the Company itself made clear that it lacks the ability to provide least cost reliable gas service to Massachusetts customers on a long-term basis (id. at 4, citing Exh. EDA-1, at 15-17). Hence, the Attorney General recommends that the Department investigate whether the Company's inability to manage basic day-to-day procurement or to optimize its assets over the long run will harm its customers (id. at 5).

2. KeySpan

The Company asserts that the Agreement contains reporting requirements that will ensure transparency of the revenue accounting under the arrangement (KeySpan Reply Brief at 6). The Company further contends that the Attorney General, in arguing that the Agreement fails to provide risk assessment requirements, points to the very section of the contract that provides for record retention and auditing of the transaction (KeySpan Reply Brief at 6). KeySpan also contends that it has retained the right under the Agreement to initiate an audit of the transactions undertaken by MLCI at any time (KeySpan Reply Brief at 6).

IV. STANDARD OF REVIEW

In evaluating a gas utility's resource options for the acquisition of commodity resources as well as for the acquisition of capacity under G.L. c. 164, § 94A, the Department examines whether the acquisition of the resource is consistent with the public interest. Commonwealth Gas Company, D.P.U. 94-174-A at 27 (1996). In order to demonstrate that the proposed acquisition of a resource that provides commodity and/or incremental resources is consistent with the public interest, a local distribution company ("LDC") must show that the acquisition (1) is consistent with the company's portfolio objectives, and (2) compares favorably to the range of alternative options reasonably available to the company at the time of the acquisition or contract renegotiation. Id.

In establishing that a resource is consistent with the company's portfolio objectives, the company may refer to portfolio objectives established in a recently approved forecast and requirements plan or in a recent review of supply contracts under G.L. c. 164, § 94A, or may describe its objectives in the filing accompanying the proposed resource. Id. In comparing the proposed resource acquisition to current market offerings, the Department examines relevant price and non-price attributes of each contract to ensure a contribution to the strength of the overall supply portfolio. Id. at 28. As part of the review of relevant price and non-price attributes, the Department considers whether the pricing terms are competitive with those for the broad range of capacity, storage and commodity options that were available to the LDC at the time of the acquisition, as well as with those opportunities that were available to other LDCs in the region. Id. In addition, the Department determines whether the acquisition satisfies the LDC's non-price objectives including, but not limited to, flexibility of nominations and reliability and diversity of supplies. Id. at 29. In making these determinations, the Department considers whether the LDC used a competitive solicitation process that was fair, open and transparent. The Berkshire Gas Company, D.T.E. 02-56, at 9 (2002); Bay State Gas Company, D.T.E. 02-52, at 8 (2002); KeySpan Energy Delivery New England, D.T.E. 02-54, at 9 (2002); The Berkshire Gas Company, D.T.E. 02-19, at 11 (2002).

V. ANALYSIS AND FINDINGS

A. Request for Proposals Process

An RFP is acceptable if the process was “fair, open and transparent.” KeySpan Energy Delivery New England, D.T.E. 04-9, at 10 (2004); Natural Gas Unbundling, D.T.E. 98-32-B at 54-55 (1999). The Department approved the RFP process used by the Company in 2004 for the existing asset management agreement, finding that the process was appropriately conducted, fair, open, and transparent. D.T.E. 04-9, at 10-11. In the instant proceeding, the bid solicitation and evaluation process was similar to the process approved in D.T.E. 04-9 in that the Company issued an RFP to an extensive list of wholesale gas marketers and conducted the process leading up to the bids in a fair and transparent manner, making all substantive communications in writing and distributing to all parties on an equal basis (Exhs. KED-AG-1-3; KED-DTE-1-2).

Nonetheless, the Attorney General argues that the Company's failure to inform all potential bidders of the change in scope (i.e., changing the structure to a co-management arrangement), which the Attorney General considers material, is grounds for rejecting the Company's proposal. The Attorney General contends that one of the bidders excluded from the short list submitted a bid priced at a value almost equal to the value of a bid priced by a short-listed bidder (Attorney General Reply Brief at 2). Because of a similar bid value, the Attorney General assumes that, had KeySpan notified all bidders of this change, there is a possibility that some may have provided bids superior to that of MLCI. The evidence does not support this assumption. In reviewing the bids submitted, the Company used a five-factor point system, of which price was only one factor. The record shows that the two competitors that were not included on the short list scored substantially lower than other competitors based on price, experience, flexibility, and creditworthiness (Exh. AG-1-2, Att. 2 (confidential)). In addition, one of the two lower-scoring competitors did not include gas procurement services, meaning that KeySpan would be responsible for procuring all gas supply under the arrangement (Exh. KED-DTE-1-6). The other lower-scoring competitor did not provide for any sharing of excess revenues for KeySpan customers and its proposed fixed payment was less than customers have previously received under the EKT Agreement (id.). In the Department's view, the lack of any procurement services by one competitor and the unwillingness to share any of the excess revenues by the other competitor effectively eliminated both competitors from consideration. As such, it was unnecessary for KeySpan to inform the two competitors of the change in structure to a co-management arrangement. Therefore, we find that KeySpan's decision not to inform the two competitors of the co-management agreement was reasonable.

In summary, the evidence demonstrates that (1) the evaluation process was outlined for bidders in the RFP and later communications between the Company and bidders; (2) the Company provided bidders with evaluation criteria and applied the evaluation criteria throughout the bid-assessment process; (3) the Company engaged in a process to provide written questions and answers to bidders, which allowed bidders to receive clarification and better understand the Company's objectives on a fair and objective basis; and (4) the Company has shown that the late change in scope would not have produced better bids from the bidders that were eliminated in the first round (see e.g., Exhs. EDA-1, at 13-15; KED-AG-1-1; KED-AG-1-2; KED-AG-1-3; KED-DTE-1-2; KED-DTE-1-6). In addition, the bids were evaluated and the winning bidder was selected based on the criteria set forth in the RFP (Exhs. KED-AG-1-1; KED-AG-1-2). Finally, the bidders raised no objection to the RFP process. Accordingly, the Department finds that the RFP process conducted by KeySpan was fair, open, and transparent, and therefore, acceptable.

B. MLCI Agreement

The Department has found that a portfolio management agreement that merely transferred managerial responsibility of gas supply contracts previously approved by the Department was consistent with portfolio objectives. D.T.E. 04-9, at 11. Similar to the EKT Agreement approved in D.T.E. 04-9, under the proposed Agreement, MLCI will assist in management of upstream interstate gas supply, transportation, and underground storage contracts previously approved by the Department (Exhs. EDA-1, at 20-21; EDA-3, at Articles II and III; Tr. at 38-39). The contracts subject to the arrangement were reviewed and approved by the Department in D.T.E. 01-105 and KeySpan Energy Delivery, D.T.E. 03-66 (2003), and are being reviewed as part of the Company's most recent long-range resource and requirements plan, which is pending before the Department in KeySpan Energy Delivery, D.T.E. 05-68.[2] Accordingly, the Department's review of KeySpan's proposal indicates that the Agreement is consistent with the portfolio objectives presented in the Company's most recent forecast and supply plan approved by the Department in KeySpan Energy Delivery, D.T.E. 01-105 (2003).

Moreover, our review of the Agreement indicates that it compares favorably to current market offerings considering price and non-price factors. The record shows that the Company will develop additional technical resources and train qualified staff in transactions involving its Massachusetts portfolio in order to ensure optimal management of the portfolio (Exhs. EDA-1,

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2 This includes KeySpan's contract with Tennessee Gas Pipeline Company relating to the ConneXion Project, which was approved by the Department in KeySpan Energy Delivery, D.T.E. 05-35 (2006).

at 18-19; KED-DTE-1-5; KED-DTE-1-10; Tr. at 34-36). The Company's stated goal is to acquire the asset optimization expertise necessary in the event of a default or lack of available asset managers (Tr. at 34-35, 38). The Department finds that such flexibility will allow the Company in the future to (1) enter into a traditional outsourcing arrangement; (2) bring management of the portfolio in-house without the assistance of an asset manager; or (3) enter into a cooperative relationship that balances reliability with revenue optimization. In addition, the record shows that because of the pricing hierarchy, customers would not pay more for their gas supplies than they would have absent the Agreement (Exhs. EDA-1, at 12, 24-25; KED-DTE-1-3; Tr. at 47-48).

The Attorney General asserts that the proposed agreement fails to meet the Department standard because it fails to compare favorably to the range of alternative options reasonably available to the Company (Attorney General Brief at 3). The Attorney General states that a review of past earnings shows that the Agreement may not produce the level of savings that customers would have received under the proposals that the Company rejected (Attorney General Brief at 3, citing Exh. KED-DTE-1-6 (confidential)). The Department finds that the Attorney General's assertion is without merit. In fact, the record indicates that the MLCI proposal is the only proposal capable of generating the highest benefits to KeySpan's Massachusetts customers (Exhs. KED-AG-1-2 (Supp.) (confidential); KED-AG-1-7 (confidential); KED-DTE-1-6 (confidential); RR-DTE-1 (confidential)).

As such, we find that the Company has demonstrated that the Agreement provides the highest possible value for customers in light of current market conditions and the need to meet critical portfolio objectives of reliability, flexibility, and diversity of supply. Given the benefits to customers in the form of the guaranteed payment, as well as any additional revenues derived from the sharing of excess revenues, the Department further finds that customers are likely to experience an overall net benefit. Therefore, the Department finds that the proposed Agreement is consistent with the public interest.

C. Margin Sharing

In D.P.U. 93-141-A at 59, the Department acknowledged that the regulatory policy of requiring all margins derived from capacity-management tools (i.e., interruptible sales, capacity release, interruptible transportation, and off-system sales) to flow to firm customers can result in a disincentive for LDCs to make investments that are in the public interest. As a result, the Department accepts margin sharing arrangements as a mechanism to improve efficiency and, ultimately, to result in cost savings to customers. Id., citing Incentive Regulation, D.P.U. 94-158, at 47-52 (1995). Nonetheless, the Department recognizes that the natural gas market has changed since the establishment of our standards delineated in D.P.U. 93-141-A. For instance, when those standards were established, the types of transactions common in the natural gas industry were interruptible transportation, capacity release, and off-system sales. Asset optimization agreements were not common and consequently not addressed by the Department. As such, the Department has previously accepted margin sharing arrangements that deviate from the capacity management tools contemplated in D.P.U. 93-141-A, where such deviation improves efficiency and produces cost savings to customers. See e.g., D.T.E. 04-9, at 13; D.T.E. 99-76, at 11 n.15 (1999).

The Attorney General argues that the Department should reject the Company's proposal because it circumvents the margin sharing rules set out in D.P.U. 93-141-A (Attorney General Brief at 4). The Company testified that it is not seeking a change in the margin sharing policy set forth in D.P.U. 93-141-A (Tr. at 17). Rather, the Company stated it is asking for treatment of revenues outside of the policy set in D.P.U. 93-141-A (Tr. at 17). Under the current EKT Agreement, the asset manager receives a percentage of revenues generated in excess of the minimum payment, and KeySpan and its customers share the remaining percentage of revenues generated in excess of the minimum payment (Exhs. EDA-1, at 24; KED-AG-1-7 (confidential); KED-DTE-1-3 (confidential)). Under the proposed Agreement, the margin sharing arrangement will be, for the most part, similar to what was previously approved in D.T.E. 04-9 (id.). However, instead of the Company sharing the margins that flow back to its customers, it would share the margins, just as it shares the risk, with MLCI (id.). As a result, KeySpan's customers will be allotted a greater percentage than under the previous EKT Agreement (id.). The Department notes that while this method of margin allocation differs from the guidelines established in D.P.U. 93-141-A, it results in a higher allocation of revenues for customers.

The Attorney General also asserts that the terms of the Agreement create an incentive for the Company to enter into transactions and procure resources that would maximize margins at the expense of Massachusetts customers (Attorney General Brief at 4, citing Exh EDA-3; Tr. at 12-15). The Department notes that neither the referenced exhibit nor the transcript support such an assertion. The Attorney General's assertion is further without merit as it overlooks the fact that KeySpan either is required to obtain Department approval of all capacity procurement transactions or is subject to Department review of such transactions. See G.L. c. 164, § 94A. As such, the Department and the Attorney General as a party would both be in a position to review any arrangements for additional capacity sought by the Company. Further, for the Attorney General's assertions to have merit, KeySpan would have to either fabricate a false need for capacity in its most recently approved supply plan or create a false analysis of available alternatives. Because the Agreement enhances the Company's ability to manage it assets in the long run and generates greater savings for customers, the Department finds that KeySpan's proposed revenue sharing allocation is in the public interest and is approved.

D. Other Issues

The Attorney General argues that the Department should reject the proposed agreement since it does not mandate audits of the transactions and fails to state risk assessment requirements that could offer some level of customer protection (Attorney General Brief at 4). The Attorney General also takes issue with the Company's statement that it will not audit transactions unless it determines that an audit is needed (id.)

The Department notes that the Company's vested interest in ensuring benefits not only for its customers but also for KeySpan provides an incentive for the Company to ensure that, under the Agreement, it enters into profitable transactions. Further, the Agreement contains reporting protocols (daily and monthly) to ensure transparency of all transactions (Exh. KED-AG-1-9). In addition, the Department notes that KeySpan has not rejected the possibility of audits. Rather, under the Agreement, the Company retains the right to conduct an audit at any time (Exh. KED-AG-1-9; Tr. at 52).

Similarly, the Attorney General asks that the Department reject the Agreement until it investigates whether the Company's inability to manage basic day-to-day procurement or optimize its assets over the long-run will harm its customers (Attorney General Brief at 5). The record indicates that the Company's existing staff and in-house resources have experience, and actively participate in (1) long-term and short-term planning and forecasting activities; (2) procurement of long-term capacity and supply resources for addition to the portfolio consistent with the planning activities; and (3) management of on-system peaking assets and related supply and operational issues (Exh. KED-AG-1-19; Tr. at 38). Further, existing staff in Massachusetts has experience with relatively basic gas transactions in terms of portfolio optimization activities (id.). The Department notes that the Company has entered into the Agreement with the goal of acquiring the expertise needed to execute more complicated financial transactions and procurement strategies (Exh. EDA-1, at 19). Therefore, the Department finds that rejecting the proposed agreement would not only have the potential of harming the Company and its customers, but would also prevent KeySpan from acquiring the necessary expertise which the Attorney General recognizes is needed.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, it is hereby

<u>ORDERED</u>: That the natural gas asset optimization services agreement between KeySpan Corporate Services, LLC, as an agent for KeySpan Energy Delivery New England, and Merrill Lynch Commodities, Inc., is hereby APPROVED; and it is

<u>FURTHER ORDERED</u>: That KeySpan Energy Delivery New England shall follow all other directives in this Order.

By Order of the Department,

/s/
Judith F. Judson, Chairman

/s/
James Connelly, Commissioner

/s/
W. Robert Keating, Commissioner

/s/
Paul G. Afonso, Commissioner

/s/
Brian Paul Golden, Commissioner

An appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part. Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of the twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. G.L. c. 25, § 5.